Report

of the

Examination of

Marcellon Town Mutual Fire Insurance Company

Pardeeville, WI

As of December 31, 2003

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State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

Jim Doyle, *Governor*
Jorge Gomez, *Commissioner*

Wisconsin.gov

125 South Webster Street • P.O. Box 7873
Madison, Wisconsin 53707-7873
Phone: (608) 266-3585 • Fax: (608) 266-9935
E-Mail: information@oci.state.wi.us
Web Address: oci.wi.gov

June 25, 2004

Honorable Jorge Gomez
Commissioner of Insurance
State of Wisconsin
125 South Webster Street
Madison, Wisconsin 53702

Commissioner:

In accordance with your instructions, an examination has been performed as of December 31, 2003, of the affairs and financial condition of:

Marcellon Town Mutual Fire Insurance Company
Pardeeville, WI

and the following report thereon is respectfully submitted:

I. INTRODUCTION

The previous examination of Marcellon Town Mutual Fire Insurance Company (the company) was made in 1999 as of December 31, 1998. The current examination covered the intervening time period ending December 31, 2003, and included a review of such subsequent transactions deemed essential to complete this examination.

The "Summary of Examination Results" contains elaboration on all areas of the company's operations. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The company was organized as a town mutual insurance company on June 21, 1889, under the provisions of the then existing Wisconsin Statutes. The original name of the company was the Mutual Fire Insurance Company of the Towns of Marcellon, Bayfield and Ft. Winnebago. Subsequent amendments to the company's articles and bylaws changed the company's name to that presently used.

During the period under examination, there was no amendment to the articles of incorporation or to the bylaws.

The company is currently licensed to write property, including windstorm and hail, and nonproperty insurance. The company is currently licensed to write business in the following counties:

Adams
Columbia
Green Lake
Marquette

A review was made of the policy and application forms currently used by the company. The company issues an approved policy with or without endorsements for a term of three years with premiums payable on the assessment and advance premium basis. The company does not charge any other fees to policyholders. Business of the company is acquired through six active agents, all of whom are directors of the company. The President is licensed to write liability business. A seventh outside agent is licensed to write liability if the President cannot write business. Agents are presently compensated for their services as follows:

Type of Policy	**Compensation**
Farm and dwelling	1 mil of risk in force
Liability	10%

Agents/directors have authority to adjust losses up to $1,000. Losses in excess of this amount are adjusted by two or more adjusters. Adjusters receive $10 for each loss adjusted plus $.25/mile for travel allowance.

Policyholders may participate in the management and control of the company by attending and voting at all annual or special meetings of the members. No member may vote by proxy. The annual meeting of the company for the election of directors and special meetings of the company are held in accordance with its articles of incorporation.

Board of Directors

The board of directors consists of six members divided into three classes. One class is elected at each annual meeting for a term of three years. Vacancies on the board may be filled by the directors for the interim to the next annual meeting when a director shall be chosen for the unexpired term.

The current board of directors consists of the following policyholders of the company:

Name	Principal Occupation	Residence	Expiry
Robert Balliet	Farmer	Portage, WI	2005
James Gorman	Carpenter	Pardeeville, WI	2005
John R. Cummings	Farmer	Endeavor, WI	2006
Maurice W. Kearns	Farmer/Secretary	Pardeeville, WI	2006
John Furman	Farmer	Montello, WI	2007
Clarence Nelson, Jr.	Farmer	Wisconsin Dells, WI	2007

All directors are agents, with only the President licensed to write liability insurance. Members of the board currently receive $10 for each meeting attended and $.25/mile for travel expenses.

Officers

Officers are elected by the board of directors from among its members and hold office for one year or until their successors are duly elected and qualified. Officers serving at the present time are as follows:

Name	Office	2004 Salary
John Furman	President	$1,000
Clarence Nelson, Jr.	Vice -President	0
Maurice Kearns	Secretary	0*
John Cummings	Treasurer	2,000

*Mr. Kearns receives an annual salary of $5,000 for duties as Manager.

Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors. The committees at the time of the examination are listed below:

Adjusting Committee
John Furman, Chair
Clarence Nelson, Jr.
Robert Balliet
James Gorman
Maurice Kearns
John Cummings

Growth of Company

The growth of the company since the previous examination as compiled from its filed annual statements was as follows:

Year	Net Premiums Earned	Policies In Force	Net Income	Admitted Assets	Policyholders' Surplus
2003	$104,885	353	$97,510	$1,294,925	$1,287,176
2002	102,090	354	60,827	1,203,673	1,192,804
2001	95,055	351	38,030	1,160,141	1,140,011
2000	95,906	355	60,527	1,107,683	1,104,240
1999	93,882	398	60,844	1,043,040	1,036,644
1998	94,990	398	38,260	1,004,112	978,277

The ratios of gross and net premiums written to surplus as regards policyholders since the previous examination were as follows:

Year	Gross Premiums Written	Net Premiums Written	Ending Surplus	Writings Ratios Net	Writings Ratios Gross
2003	$166,727	$104,956	$1,287,176	8%	13%
2002	162,597	102,816	1,192,804	9	14
2001	149,264	94,666	1,140,011	8	13
2000	146,468	95,076	1,104,240	9	13
1999	141,124	93,305	1,036,644	9	14
1998	132,845	94,975	978,277	10	14

For the same period, the company's operating ratios were as follows:

Year	Net Losses and LAE Incurred	Other Underwriting Expenses Incurred	Net Earned Premiums	Loss Ratio	Expense Ratio	Com-posite Ratio
2003	$24,898	$27,975	$104,885	24%	27%	51%
2002	64,873	30,167	102,090	64	29	93
2001	78,899	27,665	95,055	83	29	112
2000	60,812	25,172	95,906	63	26	89
1999	50,189	29,978	93,882	53	32	85
1998	77,171	28,225	94,990	81	30	111

There has been a steady increase in surplus, totaling 31.6% over the period under examination. There was a net income in each of the years, and an underwriting gain each year except for 2001. In 2001, the company experienced a large increase in net losses incurred, which can be attributed largely to wind losses. The expense ratio has been low, ranging from 26%-32%. Gross premiums written increased 25.5% while policies in force has decreased by 45 policies or

11.3%. The company ceded from 37% to 34% of its written premiums, which is lower than the average for town mutuals.

II. REINSURANCE

The examiners' review of the company's reinsurance portfolio revealed there is currently one ceding treaty. The treaty contained a proper insolvency clause and complied with s. Ins 13.09 (3), Wis. Adm. Code, concerning maximum wind loss. Company retentions of risk complied with s. Ins 13.06, Wis. Adm. Code.

Reinsurer:	Wisconsin Reinsurance Corporation
Effective date:	January 1, 2004
Termination provisions:	Either party may terminate this contract as of any subsequent January 1, by giving to the other party at least 90 days' advance notice in writing.

The coverages provided under this treaty are summarized as follows:

1.	Type of contract:	Class A, Casualty Quota Share
	Lines reinsured:	Casualty business
	Company's retention:	None, except a $1,000 deductible where raw milk contamination occurs on an insured dairy farm if there is no dairy quality assurance program. If company does not impose deductible, it agrees to retain this amount for its own un-reinsured recovery.
	Coverage:	100% of each and every loss occurrence, including LAE, in excess of the company's retention subject to the maximum policy limits of: a. $1,000,000 per occurrence, single limit or combined for bodily injury and property damage liability. b. $1,000,000 split limits, in any combination of bodily injury and property damage liability. c. $5,000 for medical payments, per person; $25,000 per accident.
	Reinsurance premium:	100% of net premiums written.
	Ceding commission:	15% of net premiums written.
2.	Type of contract:	Class B, First Surplus
	Lines reinsured:	Property business
	Company's retention:	When the company's net retention is $200,000 or more in respect to a risk, the company may cede on a pro rata basis, and the reinsurer shall be obligated to accept up to $800,000. When the company's retention is $200,000 or

		less in respect to a risk, the company may cede on a pro rata basis, and reinsurer is obligated to accept up to 50% of such risk. Plus an annual aggregate deductible amount equal to 10% of the loss and LAE otherwise recoverable.
	Coverage:	Pro rata portion of each and every loss, including loss adjustment expense, corresponding to the amount of risk ceded.
	Reinsurance premium:	The pro rata portion of all premiums, fees, and assessments charged by the company corresponding to the amount of each risk ceded. Company shall pay reinsurer 100% of the unearned premium on business covered as of January 1, 2004.
	Ceding commission:	Commission allowance of 15% of the premium ceded. Additional profit commission of 15% of the net profit accruing to the reinsurer each year calculated by a formula, with any net loss from preceding period carried forward.
3.	Type of contract:	Class C-1, Excess of Loss First Layer
	Lines reinsured:	Property
	Company's retention:	$20,000 per each and every risk resulting from one loss occurrence. Plus an annual aggregate deductible equal to $20,000 of loss.
	Coverage:	100% of each loss, including loss adjustment expense, in excess of $20,000 in respect to each and every risk resulting from one loss occurrence, limited to $60,000 each and every loss occurrence.
	Reinsurance premium:	Net premium written multiplied by the sum of four years' losses incurred by reinsurer divided by the total net premiums written for the same period multiplied by a factor of 100/80ths. Minimum Rate: 7% of the current net written premiums. Maximum Rate: 17.8% of the current net premiums written. Rate for current annual period is 7%. Deposit premium $9,900. Minimum premium $8,000.
4.	Type of contract:	Class C-2, Excess of Loss Second Layer
	Lines reinsured:	Property
	Company's retention:	$80,000 per each and every risk resulting from one loss occurrence.

	Coverage:	100% of each loss occurrence, including loss adjustment expense, in excess of $80,000 up to a maximum of $120,000.
	Reinsurance premium:	7.2% of net premiums written. Deposit premium of $10,200 with minimum annual premium of $8,200.
5.	Type of contract:	Class D/E, First Aggregate Stop Loss
	Lines reinsured:	All business written by the company
	Company's retention:	Annual net losses, including loss adjustment expense, equal to not less than 100% of net premium written, subject to a minimum retention of $112,000.
	Coverage:	100% of annual aggregate net losses, including LAE, in excess of 100% of net premiums written.
	Premium:	Net premiums written multiplied by the sum of the eight prior years' losses incurred divided by the total of the net premiums written for the same period, multiplied by the factor of 100/80ths. Minimum rate is 8% and maximum rate is 25%, of the current net written premiums. Current annual rate is 8%. Deposit premium of $11,400, minimum premium $9,100.

III. FINANCIAL DATA

The following financial statements reflect the financial condition of the company as reported to the Commissioner of Insurance in the December 31, 2003, annual statement. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Policyholders' Surplus."

Marcellon Town Mutual Fire Insurance Company
Statement of Assets and Liabilities
As of December 31, 2003

Assets	Ledger	Nonledger	Not Admitted	Net Admitted
Cash deposited in checking account	$ 19,817	$	$	$ 19,817
Cash deposited at interest	664,034			664,034
Bonds	532,680			532,680
Stocks and mutual fund investments	71,668			71,668
Investment income accrued		3,758		3,758
Fire dues recoverable	17			17
Other expense related:				
Reinsurance contingent commission receivable	2,951	0		2,951
Totals	$1,291,167	$3,758	$	$1,294,925

Liabilities and Surplus

Net unpaid losses	$ 6,130
Unpaid loss adjustment expenses	250
Unearned premiums	(3,415)
Reinsurance payable	4,583
Other liabilities:	
Expense related:	
Accounts payable	201
Total Liabilities	7,749
Policyholders' surplus	1,287,176
Total Liabilities and Surplus	$1,294,925

Marcellon Town Mutual Fire Insurance Company
Statement of Operations
For the Year 2003

Net premiums and assessments earned		$104,885
Deduct:		
Net losses incurred	$22,309	
Net loss adjustment expenses incurred	2,589	
Other underwriting expenses incurred	27,975	
Total losses and expenses incurred		52,873
Net underwriting gain		52,012
Net investment income		45,498
Net income		$ 97,510

Marcellon Town Mutual Fire Insurance Company
Reconciliation and Analysis of Surplus as Regards Policyholders
For the Five-Year Period Ending December 31, 2003

The following schedule is a reconciliation of surplus as regards policyholders during the period under examination as reported by the company in its filed annual statements:

	2003	2002	2001	2000	1999
Surplus, beginning of year	$1,192,804	$1,140,011	$1,104,240	$1,036,644	$ 978,277
Net income	97,510	60,827	38,030	60,527	60,844
Net unrealized capital gains or (losses)	(3,138)	(8,034)	(2,259)	7,069	(2,477)
Surplus, end of year	$1,287,176	$1,192,804	$1,140,011	$1,104,240	$1,036,644

Reconciliation of Policyholders' Surplus

The examination resulted in no adjustments to policyholders' surplus. The amount reported by the company as of December 31, 2003, is accepted.

IV. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

Comments and recommendations contained in the last examination report and the action taken on them by the company are as follows:

1. **Underwriting**—It is again recommended that the company perform inspections before policy renewals and document results in policy files.

   Action—Partial compliance, see comments in the summary of current examination results.

2. **Accounts and Records**—It is recommended that the company maintain a cash receipts journal as required by s. Ins 13.05, Wis. Adm. Code.

   Action—Noncompliance, see comments in the summary of current examination results.

3. **Accounts and Records**—It is again recommended that the company maintain a general ledger and general journal as required by s. Ins 13.05, Wis. Adm. Code.

   Action—Noncompliance, see comments in the summary of current examination results.

4. **Accounts and Records**—It is recommended that the company perform monthly bank reconciliations

   Action—Partial compliance, see comments in the summary of current examination results.

5. **Disaster Recovery Plan**—It is recommended that the company develop a disaster recovery plan.

   Action—Partial compliance, see comments in the summary of current examination results.

6. **Cash and Invested Cash**—It is recommended that the company comply with s. 610.23, Wis. Stat.

   Action—Compliance.

7. **Net Unpaid Losses**—It is recommended that the company comply with s. Ins 13.05 (4) (e), Wis. Adm. Code, and assign claim numbers to claims at the time they are first reported to the company.

   Action—Compliance.

8. **Net Unpaid Losses**—It is recommended that the company include sufficient documentation in its claim files in order to establish compliance with the applicable regulations.

   Action—Noncompliance, see comments in the summary of current examination results.

Current Examination Results

Corporate Records

The minutes of the annual meetings of policyholders and meetings of the board of directors and committees thereof, were reviewed for the period under examination and also for the subsequent period. It was noted that the annual policyholders meeting is not held at the Marcellon School in Pardeeville at 8:00 p.m., as stated in the articles of incorporation. Since 1997 the annual meeting has been held at the Portage Public Library at 11:30 a.m. The company does send a notice each year to all policyholders as prescribed by the articles.

The Treasurer's report is read and approved at each board meeting. The review of the minutes did not indicate authorizations for the purchases and sales of investments. According to s. 6.20 (6), Wis. Adm. Code, "investments acquired and held under this section shall be acquired and held under the supervision and direction of the board of directors." It is recommended that the minutes indicate that all investment purchases and sales transactions have been discussed during meetings of the board of directors, and that the minutes indicate whether the individual transactions were approved or disapproved.

The company adopted a new investment plan dated June 1, 2004, called the "Investment Policy Statement." This statement assigns responsibility to the Investment Committee and an Executive Committee, which appoints and/or delegates to the investment manager; the statement must be reviewed by the board on an annual basis; and there is to be a complete audit of the company's investments conducted on an annual basis by a CPA firm. Currently the company does not have Investment or Executive Committees; and a CPA compiles the annual statement but does not issue an audit report. It is recommended that the company write an investment policy consistent with how the company invests and operates. It is noted that the board established an Investment Committee in July 2004. The original investment plan dated June 3, 1999, only discussed having investments of 95% in C.D.'s and 5% in stock of its reinsurer, and did not cover bonds.

Biographical data relating to company officers and directors have been reported in accordance with the provisions of s. Ins 6.52, Wis. Adm. Code.

The company has executed a formal written agreement with a director licensed to write liability business. However, the contract only covers liability insurance. The contract includes language indicating the agent will represent the company's interests "in good faith." Five other directors who write for the company, but who are not licensed to write liability business do not have written agent agreements with the company. It is recommended that all agents who write for the company or are licensed to write for the company have formal written agreements that cover all insurance written.

Conflict of Interest

In accordance with a directive of the Commissioner of Insurance, each company is required to establish a procedure for the disclosure to its board of directors of any material interest or affiliation on the part of its officers, directors, or key employees which conflicts or is likely to conflict with the official duties of such person. A part of this procedure is the annual completion of a conflict of interest questionnaire by the appropriate persons. The company has adopted such a procedure for disclosing potential conflicts of interest. Conflict of interest questionnaires were reviewed for the period under examination with no apparent conflicts being noted.

Fidelity Bond and Other Insurance

The company is afforded coverage under the terms of the following bonds or contracts and has complied with s. Ins 13.05 (6), Wis. Adm. Code, which sets forth the minimum requirements for fidelity bond coverage:

Type of Coverage	**Coverage Limits**
Fidelity bond	$65,000 per named
Worker's Compensation:	
Employee injury	WI Statutory
Employee liability:	
Each accident	$100,000
Each employee	$100,000
Policy limit	$500,000
Agents Errors and Omissions	$1 million each claim and aggregate
Directors & Officers and Professional Liability	$1 million each claim and in aggregate

Underwriting

The company has a written underwriting guide. The guide covers all the lines of business that the company is presently writing. Farm and dwelling is sold on the assessment basis with rates based on the type of coverage. The company does not do much underwriting on this business. Liability and homeowner city policies have advance premium with different rates. All of the policies are sold with no deductibles.

The company does not have a formal inspection procedure for both new and renewal business. The company does not have a separate inspection form, except the questionnaires on the back of the applications. A review of the application forms noted that they are not always fully completed. New applications and renewal business is inspected by the agent writing the policy, and when the policy is rewritten every three years. Directors write their own policies. Policies are not inspected by persons who are independent of the risk under consideration and review. Also, the dwelling questionnaire and application is not used for city policies, as most agents use the farm application. It is again recommended that the company use a formal inspection form, that a procedure be developed for inspecting a sample of new and renewal business by persons independent of the policy, that the application or inspection forms be fully completed, and that the dwelling questionnaire and application be used for city policies. The company can determine which policies might need inspection based on criteria such as risk in force, property age and loss history.

For endorsements to policies a new declaration page is not sent but the company sends a form showing changes and the new policy insurance total. The company does not include a copy of the form in the insured's policy file but marks the original declaration page in the policy file. This makes changes hard to follow, as changes are just noted on the declaration page in the file. It is recommended that the company place a copy of the endorsement form in the policyholder's file for changes to the policy. The company has now started sending a copy of the form to the agent when changes are made.

Claims Adjusting

The company has an adjusting committee consisting of at least three directors as required by s. 612.13 (4), Wis. Stat. The function of this committee is to adjust or supervise the adjustment of losses. The adjusting committee consists of all six board members.

Accounts and Records

The examiners' review of the company's records indicated that the company is not in compliance with s. Ins 13.05, Wis. Adm. Code, which sets forth the minimum standards for the handling of cash and recording of cash transactions by town mutual insurance companies. The examiners noted the following:

1. A proper policy register is maintained
2. A proper cash receipts journal is not maintained
3. A proper cash disbursements journal is maintained
4. A proper general journal is not maintained
5. A proper general ledger is not maintained

The company did not maintain a comprehensive cash receipts journal, although it appears all receipts are being accounted for. There was not a full record of amount received, date received, policyholder name and policy number. It is again recommended that the company maintain a cash receipts journal as required by s. Ins 13.05, Wis. Adm. Code.

A complete general ledger and general journal are not maintained to document all transactions of the company. Bank transfers, interest reinvested, and banking fees are not included in an intermediate document prepared by the company, known as the insurance transactions report, as it only documents transactions with the bank with the main operating accounts. The insurance transactions report is then used to make entries to the general ledger. Therefore, any transactions outside of the applicable bank are not included in the general ledger. It is again recommended that the company maintain a general ledger and general journal as required by s. Ins 13.05, Wis. Adm. Code.

The company failed to perform bank reconciliations on a timely basis. Bank reconciliations are done for the 12 months at the end of the year, not at the end of each month. It is again recommended that the company perform bank reconciliations monthly and on a timely basis.

The company does not have records listing all of its investments. At the time of the prior examination, the company did not own any bonds, it owned mostly C.D.'s. A review of bonds listed in the annual statement noted that the type, maturity date, purchase date, and reporting of CMOs was not always correct or reported. It is recommended that the company maintain an investment ledger for each investment. An investment ledger should have a page for each investment, listing purchase and sale amounts, any pay downs of bond principal, and investment income received. Adherence to this recommendation will enable the company to maintain better accounting control over its investments.

An extensive review was made of income and disbursement items. Cash receipts were traced from source records and the proper recording and eventual deposit thereof ascertained. Negotiated checks issued during the period under examination were reviewed, test checked for proper endorsement, and traced to cash records. The verification of assets and determination of liabilities were made as of December 31, 2003.

The company is not audited annually by an outside public accounting firm.

EDP Environment

Company personnel were interviewed with respect to the company's electronic data processing environment. The company does not regularly use computers to process its data. Certain information is produced with a computer once a year. The information is entered and backed-up off-site.

Business Continuity Plan

A business continuity plan identifies steps to be performed by a company in the event of the loss of business interruptions including, but not limited to, the loss of a key employee, the loss of information, the destruction of its office building, or the inability to access a computer. The company has not developed a business continuity plan, as was recommended in the prior examination report. It is again recommended that the company develop a business continuity plan and file such with this office within 180 days of the adoption of this report.

Business Plan

It is time for the company's board of directors to develop a business plan. The business plan would document plans for the future as well as focus on current problems. The board should focus on the long-range plans and goals of the company, but also decide how the company will comply with the recommendations made in this examination and from prior examination reports. The board needs to develop a long-range plan if the company is going to continue operating as a town mutual insurance company. Given the findings of this and previous examination reports and the age of the current officers, the board needs to consider: hiring a manager to run the company, having a modern record-keeping system, and changing to an advance premium basis. (If the board wants to change to the advance premium basis, it could consider issuing a dividend to policyholders to avoid requiring a double premium payment, or a dividend could be issued in connection with a merger.) It is recommended that the company establish a business plan that will address the long-range plans of the company and the current examination recommendations, and submit a copy of the plan to the Commissioner within 90 days of the adoption of this report.

Invested Assets

Section 610.23, Wis. Stat., requires insurers to hold all investments and deposits of its funds in its own name except that:

> (1) Securities kept under a custodial agreement or trust arrangement with a bank or banking and trust company may be issued in the name of a nominee of the bank or banking and trust company; and
>
> (2) Any insurer may acquire and hold securities in bearer form.

For securities not held under a custodial agreement or trust arrangement with a bank or banking and trust company, s. Ins 13.05 (4), Wis. Adm. Code, requires that:

> Non-negotiable evidences of company investments such as registered bonds, certificates of deposits, notes, etc., shall be maintained in a safe or vault with adequate safety controls or in a safety deposit box in a bank. Negotiable evidences of company investments shall be maintained in a safety deposit box in a bank. Access to a company safety deposit box containing negotiable securities shall require the presence and signature of at least 2 officers, directors or employees of the company.

The company is not in compliance with these requirements. Bonds and a mutual fund investment are being held by three brokerage firms. The securities are not held under a proper custodial agreement, with a bank or banking and trust company that meets the standards and provisions established by the NAIC Examiners Handbook. The company must obtain possession of all their investments and place them in a safe or in a safety deposit box, or with a bank or banking and trust company under a proper custodial agreement. It is recommended that the company comply with s. 610.23, Wis. Stat., and s. Ins 13.05, Wis. Adm. Code, as regards custody and control of its invested assets, and by not having brokerage firms hold securities.

The company did not have a copy of all bank and brokerage statements and purchase and sale advices. It is recommended that the company comply with s. Ins 6.80 (4), Wis. Adm. Code, for retention of records, including bank and brokerage statements and purchase and sale advices.

Investment Rule Compliance

The investment rule for town mutual insurers allows a company to invest in common stocks, common stock mutual funds, and other higher risk investments (referred to as “Type 2”) provided that the town mutual has a sufficient amount of lower risk investments (referred to as “Type 1”). A town mutual may invest in Type 2 securities only if it already has sufficient Type 1 investments. Type 1 investments must equal or exceed the greater of items 1, 2, or 3.

1.	Liabilities plus $300,000	$307,749
2.	Liabilities plus 33% of gross premiums written	62,769
3.	Liabilities plus 50% of net premiums written	60,327
4.	Amount required (greater of 1, 2, or 3)	307,749
5.	Amount of Type 1 investments as of 12/31/2003	999,716
6.	Excess	$691,967

The company has sufficient Type 1 investments.

ASSETS

Cash and Invested Cash **$683,851**

The above asset is comprised of the following types of cash items:

Cash deposited in banks-checking accounts	$ 19,817
Cash deposited in banks at interest	664,034
Total	$683,851

Cash deposited in banks subject to the company's check and withdrawal consists of one account maintained in a local bank. Verification of checking account balances was made by obtaining confirmations directly from the depositor and reconciling the amounts shown thereon to company records.

Cash deposited in banks represents the aggregate of eight deposits in seven depositories. Deposits were verified by direct correspondence with the respective depositories and by an actual count and inspection of certificates and/or passbooks. Interest received during the year 2003 totaled $23,654 and was verified to company cash records. Rates of interest earned on cash deposits ranged from 0.38% to 4%. Accrued interest on cash deposits totaled $1,255 at year-end.

Book Value of Bonds **$532,680**

The above asset consists of the aggregate book value of bonds held by the company as of December 31, 2003. Bonds owned by the company are located at three brokerage firms.

Bonds could not be physically inspected by the examiners. Bonds at the brokerage firms were traced to year-end broker statements. Bond purchases and sales for the period under examination were checked to brokers' invoices and advices. The company's investment in bonds was in conformance with Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers, except as regards custody. Two bonds are over 3% of admitted assets, but the company has received permission from this office to hold these two bonds until maturity. A recommendation regarding the custody and control of investments can be found in the Invested Assets section of this report.

Interest received during 2003 on bonds amounted to $22,910 and was traced to cash receipts records. Accrued interest of $2,503 at December 31, 2003, was checked and allowed as a nonledger asset.

Stocks and Mutual Fund Investments **$71,668**

The above asset consists of the aggregate market value of stocks and mutual funds held by the company as of December 31, 2003. Stocks owned by the company are located in safety deposit box at a bank. As noted in the Invested Assets section of this report, the company owns a mutual fund that is being held by a brokerage firm. It is recommended the company have all mutual fund investments held in its own name in order to comply with s. 610.23, Wis. Stat.

Stock certificates were physically examined by the examiners. Mutual fund values were traced to year-end broker statements. Stock and mutual fund purchases and sales for the period under examination were checked to brokers' invoices and advices. The company's investment in stocks and mutual funds was in conformance with Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers, except as regards custody.

Dividends received during 2003 on stocks and mutual funds amounted to $1,982 and were traced to cash receipts records. There were no accrued dividends at December 31, 2003.

Investment Income Due and Accrued **$3,758**

Interest due and accrued on the various assets of the company at December 31, 2003, consists of the following:

Cash at interest	$1,255
Bonds	2,503
Total	$3,758

Fire Dues Recoverable **$17**

This asset represents the amount overpaid to the State of Wisconsin for 2003 fire dues. The examiners reviewed the company's fire department dues calculation and found this asset to be correctly calculated. The actual amount paid was verified to the cash disbursement records.

Reinsurance Contingent Commission Receivable **$2,951**

The above asset represents the amount of reinsurance commissions that the company expected to receive as of December 31, 2003, based on the profitability of the business ceded under its contract with Wisconsin Reinsurance Corporation. A review of the terms of the reinsurance agreement and year-end accountings with the reinsurer verified the above asset.

LIABILITIES AND SURPLUS

Net Unpaid Losses **$6,130**

This liability represents losses incurred on or prior to December 31, 2003, that remained unpaid as of that date. The examiners reviewed the reasonableness of this liability by totaling actual loss payments made subsequent to December 31, 2003, with incurred dates in 2003 and prior years. To the actual paid loss figure was added an estimated amount for 2003 and prior losses remaining unpaid at the examination date. The examiners' development of unpaid losses is compared with the amount estimated by the company in the following schedule.

	Company Estimate	Examiners' Development	Difference
Incurred but unpaid losses	$7,030	$6,700	$ 330
Less: Reinsurance recoverable on unpaid losses	900	0	900
Net Unpaid Losses	$6,130	$6,700	$(570)

The above difference of $570 was not considered material for purposes of this examination. However, the ability to perform a complete loss development was limited as described below.

The examiners' review of claim files included open claims, paid claims, claims closed without payment, and claims which were denied during the examination period. The loss register did not show any claims in 2003 were closed without payment. The review indicated that there was not always enough information to determine if claims are investigated and evaluated properly. Payments are made promptly and in accordance with policy provisions upon the submission of a proper proof of loss. In addition, the review of claims handling procedures and files revealed the following:

1. A proper loss register is not maintained.
2. Claim files did not contain sufficient investigatory data and documentation to verify settlement payments or reserve estimates.
3. Proofs of loss were properly signed.

The examination noted that the company’s loss register included the required format of s. Ins 13.05, Wis. Adm. Code. However, the examination revealed that claims reported to the company were not always entered in the loss register properly. The Secretary often records the day after the loss date as the reported date. Claim information is often not given to the Secretary by the Director adjusting the claim until the monthly board meeting or not until the claim is to be paid. The company has a 'Loss Notice' form to report losses but this is usually not completed by the directors/agents, and the loss number is not put on the form by the Secretary. It is recommended that the company maintain a proper loss register to comply with s. Ins 13.05 (3) (f) and (4) (e), Wis. Adm. Code, and that agents and directors report claims promptly to the company. When a claim is reported to an agent or a Director, this is the reported date of the claim.

The company did not maintain adequate documentation in their claim files. Open claims did not have documentation to see if they are being investigated and evaluated properly. Also, some closed claims did not have documentation and/or receipts to verify what was paid. There is no loss inspection written up on the evaluation of the claim. The company often does not have written claim information until a signed proof of loss is handed in. Because of the combination of not having the proper information for recording claims in the loss register and the insufficient documentation included in the claim file, the examiner was unable to determine the proper loss development. It is again recommended that the company include sufficient documentation in open and closed claims including the proper receipts in order to comply with s. Ins 13.05 (4) (e), Wis. Adm. Code, and that the company have a loss inspection form completed by the adjuster(s) when a loss is inspected. The company also could adopt a minimum amount for which receipts would not be required.

The examination also noted that the company had claims open for several years without settlement, while the company waits for information from the claimant or for the insured to repair covered damages. This is a practice that increases the company's exposure to additional loss sustained on damaged and unrepaired property. Three claims were open from 2001 and 2002 at the time of the examination. The examiners informed the company about the importance of adopting procedures so all claims are settled and closed more promptly. The company should send letters on outstanding claims requesting the information needed so that the company can pay claims after receipt of proper documentation. It is recommended that the company adopt procedures for timely settlement of claims and follow up on claims within a reasonable amount of time in compliance with s. 628.46, Wis. Stat., and s. Ins 6.11, Wis. Adm. Code.

Unpaid Loss Adjustment Expenses **$250**

This liability represents the company's estimate of amounts necessary to settle losses which were incurred prior to December 31, 2003, but which remained unpaid as of year-end. The methodology used by the company in establishing this liability is to total expected loss adjustment expenses for open claims.

The examiners' analysis of expenses incurred in the current year related to the settlement of prior year losses, as well as estimates of amounts necessary to settle any prior losses remaining unpaid at the examination date, determined this liability to be adequately stated.

Unearned Premiums **$(3,415)**

This liability represents the reserve established for unearned premiums in compliance with s. Ins 13.08 (3), Wis. Adm. Code. This reserve was established using 50% of prepaid annual premiums written, reduced by ceded unearned premiums.

Premiums for most policies were collected on the post-assessment basis, while premiums ceded on these policies were paid in advance to the reinsurer. At year-end premiums ceded and unearned exceeded unearned premiums on prepaid policies, resulting in a negative amount of unearned premiums.

Reinsurance Payable **$4,583**

This liability consists of the net amounts due to the company's reinsurer at December 31, 2003, relating to transactions which occurred on or prior to that date. It consisted of the following amounts net of commissions:

Class A	$2,283
Class C-1	700
Class C-2	700
Class D/E	900
Total	$4,583

Accounts Payable **$201**

This liability consists of unpaid expenses as of December 31, 2003. Verification was done through a review of subsequent payments, and determined this liability to be adequately stated.

V. CONCLUSION

Over the period under examination, the company has had a steady increase in surplus, which has increased 31.6% to $1,287,176 as of year-end 2003. There was net income each of the years under examination and underwriting gains in four of the five years. In 2001, the company had an underwriting loss due to wind claims. The company has had low expense ratios, ranging from 26%-32%. One point of concern is the continued decrease in the number of policies in force.

The company has consistently reported net incomes and good underwriting results, which is a compliment to the board of directors and officers. Expenses are very modest, and despite issuing policies with zero deductibles (which very few other companies permit) the company has good loss ratios. However, the company needs to address long-term planning, including planning for the next generation of directors, and obtain good accounting and record-keeping assistance.

There were no adjustments to surplus from the examination. The current examination report has 17 recommendations. Six of the eight recommendations from the prior examination report are repeated, as there was noncompliance or only partial compliance. A number of the current recommendations are related to record keeping, documentation of transactions, and control of invested assets. However, the most important ones are an urgent need of a business plan for the future of the company and a business continuity plan.

Serious plans need to be made if the company is going to continue operating as a town mutual insurance company. The board of directors and the officers have to put a lot more emphasis on the future of the company and in complying with the recommendations in the examination report. The business plan should not only include how the company will comply with the current recommendations but also long-range plans concerning the company's direction and goals. The company needs to determine who will run the company, as all of the officers are over 70 years of age. This will probably mean hiring a qualified manager, which will likely increase expenses. Another objective to consider is the conversion to advance premium from the assessment basis. The company should also consider maintaining the company records using a computer.

VI. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 14 - Corporate Records—It is recommended that the minutes indicate that all investment purchases and sales transactions have been discussed during meetings of the board of directors, and that the minutes indicate whether the individual transactions were approved or disapproved.

2. Page 14 - Corporate Records—It is recommended that the company write an investment policy consistent with how the company invests and operates.

3. Page 15 - Corporate Records—It is recommended that all agents who write for the company or are licensed to write for the company have formal written agreements that cover all insurance written.

4. Page 16 - Underwriting—It is again recommended that the company use a formal inspection form, that a procedure be developed for inspecting a sample of new and renewal business by persons independent of the policy, that the application or inspection forms be fully completed, and that the dwelling questionnaire and application be used for city policies.

5. Page 16 - Underwriting—It is recommended that the company place a copy of the endorsement form in the policyholder's file for changes to the policy.

6. Page 17 - Accounts and Records—It is again recommended that the company maintain a cash receipts journal as required by s. Ins 13.05, Wis. Adm. Code.

7. Page 17 - Accounts and Records—It is again recommended that the company maintain a general ledger and general journal as required by s. Ins 13.05, Wis. Adm. Code.

8. Page 17 - Accounts and Records—It is again recommended that the company perform bank reconciliations monthly and on a timely basis.

9. Page 17 - Accounts and Records—It is recommended that the company maintain an investment ledger for each investment.

10. Page 18 - Business Continuity Plan—It is again recommended that the company develop a business continuity plan and file such with this office within 180 days of the adoption of this report.

11. Page 19 - Business Plan—It is recommended that the company establish a business plan that will address the long-range plans of the company and the current examination recommendations, and submit a copy of the plan to the Commissioner within 90 days of the adoption of this report.

12. Page 19 - Invested Assets—It is recommended that the company comply with s. 610.23, Wis. Stat., and s. Ins 13.05, Wis. Adm. Code, as regards custody and control of its invested assets, and by not having brokerage firms hold securities.

13. Page 20 - Invested Assets—It is recommended that the company comply with s. Ins 6.80 (4), Wis. Adm. Code, for retention of records, including bank and brokererage statements and purchase and sale advices.

14. Page 22 - Stocks and Mutual Funds—It is recommended the company have all mutual fund investments held in its own name in order to comply with s. 610.23, Wis. Stat.

15. Page 25 - Net Unpaid Losses—It is recommended that the company maintain a proper loss register to comply with s. Ins 13.05 (3) (f) and (4) (e), Wis. Adm. Code, and that agents and directors report claims promptly to the company.

16. Page 25 - Net Unpaid Losses—It is again recommended that the company include sufficient documentation in open and closed claims including the proper receipts in order to comply with s. Ins 13.05 (4) (e), Wis. Adm. Code, and that the company have a loss inspection form completed by the adjuster(s) when a loss is inspected.

17. Page 25 - Net Unpaid Losses—It is recommended that the company adopt procedures for timely settlement of claims and follow up on claims within a reasonable amount of time in compliance with s. 628.46, Wis. Stat., and s. Ins 6.11, Wis. Adm. Code.

VII. ACKNOWLEDGMENT

The courteous cooperation extended to the examiners by the company's personnel is hereby acknowledged.

In addition to the undersigned, Rebecca Easland of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination:

Respectfully submitted,

Andrew M. Fell
Examiner-in-Charge